

Report of Examination
of
The Farmers Union Mutual Fire Insurance Company of
Bradley County, Tennessee

David Campbell, Secretary
P. O. Box 1016
915 25th Street NW
Cleveland, TN 37364-1016

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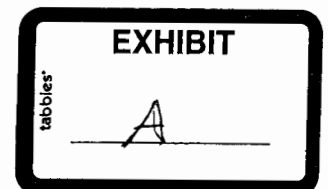
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Dept. Of Commerce & Insurance
Company Examinations

Examination made as of: December 31, 2003

Examiner in Charge: James T. Pearce, Examiner III

Examination commenced: April 6, 2004



Date of Report: November 23, 2004

Examined as of: December 31, 2003

Last Examination as of: December 31, 1998

Commissioner Paula A. Flowers
Department of Commerce and Insurance
State of Tennessee
Nashville, Tennessee 37243

Commissioner:

Pursuant to your instructions, I have made an examination and submit the following report of the conditions and affairs of the

Farmers Union Mutual Fire Insurance Company of Bradley County, Tennessee

Cleveland, Tennessee

Officers

Title	Name	Address	Term
President	John Eads	Cleveland, TN	January 2005
Vice President	John H. Johnson	Cleveland, TN	January 2005
Secretary & Treasurer	David Campbell	Cleveland, TN	January 2006

Directors:

Name	Address	Term Expires
John Eads, President	Cleveland, TN	January 2005
John H. Johnson, Vice President	Cleveland, TN	January 2005
David Campbell, Secretary & Treasurer	Cleveland, TN	January 2006
David Beaty	Cleveland, TN	January 2007
Robert Still	Cleveland, TN	January 2006
Milton Humberd, Jr.	Cleveland, TN	January 2007
Lester Elkins	Georgetown, TN	January 2007

Compensation of officers, directors, appraisers, adjusters, et al:

The president receives \$500 per year and \$50 per called meeting, the vice president receives \$500.00 per year and \$50 per called meeting, the manager / secretary / treasurer receives \$40,500.00, the Company's agent / clerk receives \$20,000.00 per year and 35 cents per mile and the second clerk \$21,500 . The directors receive \$500 per year (semi-annually) and \$50 per called meeting and the Company's attorney receives a \$200 retainer if no services are rendered during the year. In 2003 all employees received a bonus based upon the amount of months employed with the Company as directed by the Board of Directors. The bonuses ranged from \$375 to \$2,000.

Report of changes in the Constitution or By-Laws, policy forms, or other agreements during the period covered by this examination.

NONE

Changes to the Company's rate schedule and placement guide were made on December 11, 2000 and have been continuously in effect with the approval of the Company's Board of Directors through the end of 2003.

The Company's rate schedule and placement guide for all new or renewal policies written are included in the work papers of this examination report. Copies of the minutes of the Board of Directors meeting at which the policy rates were changed are included in the work papers of this examination report.

If copies have not been filed with the Department of Commerce and Insurance, are they filed with the work papers of this report?

The changes to the rate schedule were not filed with the Department and are included in the Company's policy form. Copies of the minutes of the Board of Directors meeting at which the policy rates were changed are included in the work papers of this examination report.

Report on reinsurance assumed and / or ceded.

Effective January 1, 2002 the Company started ceding reinsurance through a consortium of carriers including Arch Reinsurance Company, Excess Reinsurance Company, Employers Mutual Casualty Company and Farm Mutual Reinsurance Plan, Inc. All of the reinsurance agreements are brokered through Guy Carpenter of Philadelphia, PA which is a division of Marsh McLennan.

The Company had four (4) separate reinsurance agreements with Guy Carpenter (insurance broker) as of December 31, 2003. They are as follows : (1) Obligatory First Surplus Reinsurance Treaty (2) Facultative Binding Authority Reinsurance Agreement (3) Aggregate Excess of Loss Reinsurance Agreement. (4) Second Aggregate Excess of Loss Reinsurance Agreement.

The contract terms of the Company's Second Aggregate Excess of Loss Reinsurance Agreement discloses that Farm Mutual Reinsurance Plan, Inc. insures 20% of the total risk within this agreement. Farm Mutual Reinsurance Plan, Inc. as of December 31, 2003 was not a licensed insurance company in the State of Tennessee or an authorized reinsurer in the State of Tennessee.

The Company's maximum retention on any single loss was \$25,000.

The Obligatory First Surplus Reinsurance Treaty through Guy Carpenter paid the Company for any single loss over the Company's \$25,000 single policy maximum and under the \$100,000 treaty limit. This Obligatory First Surplus Reinsurance Treaty is on a pro-rata basis.

All amounts on a single risk over \$100,000 were reinsured or ceded to the Facultative Binding Authority Reinsurance Agreement.

All losses are divided on a pro-rata basis between the Company's retention and the Obligatory First Surplus Reinsurance Treaty and the Facultative Binding Authority Reinsurance Agreement.

Two Aggregate Contracts are carried on the Company's retained insurance.

The First Aggregate Contract starts if the Company should lose 74% of one year's net premiums and pays up to \$348,000.

The Second Aggregate Contract starts if the Company should lose more than the First Aggregate pays and the Second Aggregate Contract pays up to 1000% of the Company's Annual Net Premiums.

Appraisal and classification of risks taken.

Policies are typically written for the full value of the property insured subject to policy limits of \$25,000 per risk before reinsurance. The agent performs the appraisal on the property prior to the issuance of a policy during the application process. Property eligible to be insured includes dwellings and contents, church buildings, farm buildings and contents, crops in barns, chicken houses, farm machinery, cattle and some unusual commercial type property.

Annual rate of assessment per \$1,000.00 for period covered:

See the attachment to the Exam Report for the Company's rate schedule and placement guide, effective since December 11, 2000, for all new or renewal policies written.

Rate of membership, policy and initial fees charged.

As of December 31, 2003, the Company had \$21,000,497 of total insurance in force (net of reinsurance ceded). There were no policy or membership fees charged to policyholders. Policyholders have the option of paying their premiums either on an annual or semi-annually basis. No service charges were levied if premiums were paid late.

Date of last assessment.

The Company makes advance assessments of its members on the policy renewal date.

Amount delinquent.

There have never been any delinquencies. The Company cancels policies if assessments are not paid within forty five (45) days after the end of the policy period.

Did that assessment provide for all losses, expenses and other liabilities, including borrowed money?

Yes

Amount of money borrowed since date of last assessment.

The Company did not borrow any money during the period of examination.

Exhibit of Risks

	<u>Number</u>	<u>Amount</u>
1. In force, December 31, 2002		\$50,661,015
2. Written		6,931,450
3. Total		57,592,465
4. Deduct those expired and marked off as terminated		(5,781,050)
5. In-force, December 31, 2003		51,811,415
6. Amount Re-insured		(30,810,918)
7. Net Amount In force, December 31, 2003		<u>\$21,000,497</u>

Financial Statement

Income

Gross Membership Fees (New Policy Premiums)	\$29,084.00
Gross Assessments	376,055.00
Deduct: Reinsurance Premiums	108,631.00
Deduct: Return Assessments	<u>4,792.00</u>
Net Assessments	\$262,632.00
Interest Income on Investments	52,443.00
Reinsurance Commission Adjustments	20,800.00
Vandalism Claim Recoveries	5,048.00
Phone Company and Tax Refunds	<u>122.00</u>
Total Income	\$370,129.00
Ledger Assets, December 31, 2002	<u>\$1,473,139.00</u>
Total Income and Balance, as of December 31, 2003	\$1,843,268.00

Disbursements

Gross amount paid policyholders for losses	\$164,372.00
Deduct: Reinsurance Loss Recoveries	<u>77,873.00</u>
Net amount paid policyholders for losses	\$86,499.00
Expenses of adjustment and settlement of losses	0.00
Commission of brokerage, including membership fees retained by Agents	0.00
Salaries and compensation of officers, directors, & employees	105,830.00
Advertising, Printing and Stationery	3,834.00
Postage, telegrams, telephones and express	8,974.00
Legal Expenses	1,750.00
Rent Including Utilities	12,000.00
Insurance department licenses and fees	6,340.00
All other licenses, fees and taxes	17,982.00
Bank Charges	175.00
Repairs	53.00
Vehicle Expanse	2,503.00
Office Supplies	5,699.00
Contributions	865.00
Insurance	4,579.00
Dues	2,314.00
Meals & Entertainment	131.00
Travel	1,893.00
Miscellaneous Expenses	1,446.00
Total disbursements	<u>\$262,867.00</u>
Balance as of December 31, 2003	<u>\$1,580,401.00</u>

Balance Sheet

There follows a statement of assets and liabilities as of December 31, 2003 together with a reconciliation of surplus, as established by this examination.

Assets

	<u>Admitted Assets Per Company</u>	<u>Non-Admitted Assets Per Examination</u>	<u>Net-Admitted Assets Per Examination</u>
Book Value of Bonds and Stocks	\$211,500	*\$200,000	\$11,500
Cash in Company's Office	400		400
Cash in Banks (Including C. D.s and Money Market)	<u>1,368,501</u>	*11,246	<u>1,357,255</u>
Total Cash	1,368,901		1,368,501
TOTAL ASSETS	<u>\$ 1,580,401</u>	<u>*\$ 211,246</u>	<u>\$ 1,369,155</u>

Liabilities, Surplus and Other Funds

	<u>Liabilities and Surplus Per Company</u>	<u>Examination Adjustments</u>	<u>Liabilities and Surplus Per Examination</u>
Salaries, Notes Expense, Bills, Accounts, Fees, etc. Due Or Accrued	<u>\$2,293</u>		<u>\$2,293</u>
TOTAL LIABILITIES	\$2,293		\$2,293
Surplus as Regards Policyholders	<u>\$1,578,108</u>	<u>*\$211,246</u>	<u>\$1,366,862</u>
TOTALS	<u>\$ 1,580,401</u>	<u>*\$ 211,246</u>	<u>\$ 1,369,155</u>

* See the Investments Held Without a Custodial / Safekeeping Agreement and Balance Sheet Error heading (below) under the **Comments on any apparent violations of the laws of the State of Tennessee** section of this report.

Assets

Schedule of Bank Deposits:

<u>Name of Bank</u>	<u>Amount on Bank Statement</u>	<u>Amount of O/S Checks</u>	<u>Adj. Items</u>	<u>Balance</u>
First Tennessee Bank, Cleveland, TN Business Checking	\$53,163.56	(\$924.23)	\$-0-	\$52,239.33
First Tennessee Bank, Cleveland, TN, Priority Business Savings	\$134,900.43	\$-0-	\$-0-	\$134,900.43
Suntrust Bank, Cleveland, TN,	<u>\$20,101.21</u>	<u>\$-0-</u>	<u>\$-0-</u>	<u>\$20,101.21</u>
	<u>\$208,165.20</u>	<u>(\$924.23)</u>	<u>\$-0-</u>	<u>\$207,240.97</u>

Schedule and description of all other assets, including real estate, mortgage loans, bonds, etc., and interest or rents due or accrued thereon:

Certificates of Deposit (Admitted per Examination):

Suntrust Bank of Cleveland, TN	\$100,000.00
AmSouth Bank of Cleveland, TN	\$100,000.00
BB&T Trust Bank of Calhoun, TN	\$100,000.00
Bank of Cleveland, Cleveland TN	\$100,000.00
Community Trust Banking Cleveland, TN	\$100,000.00
First Tennessee Bank of Cleveland, TN	\$50,000.00
Peoples Bank of Polk County of Benton, TN	\$100,000.00
Benton Banking of Benton, TN	\$50,000.00
Benton Banking of Benton, TN	\$50,000.00
Southern Heritage Bank of Cleveland, TN	\$100,000.00
State Farm Bank	\$100,000.00
First Citizens Bank of Cleveland, TN	\$100,000.00
Union Planters Bank of Cleveland, TN	<u>\$100,014.11</u>
Total Certificates of Deposit	\$1,150,014.11

Assets (continued)

Bonds (Non-Admitted per Examination):

FHLB \$100,000 par, at 5.6% maturing 5/10/06	\$100,000.00
FHLB \$100,000 par, at 2.645% maturing 12/12/06	<u>\$100,000.00</u>
Total Bonds	\$200,000.00

Stocks (Admitted per Examination):

First Assurance Bancorp (200 shares)	\$10,000.00
Namic Insurance Company (30 shares)	<u>\$1,500.00</u>
Total Stocks	\$11,500.00

Money Market Mutual Funds (Non-Admitted per Examination):

RMA Money Market Portfolio	<u>\$11,245.92</u>
Total Money Market Mutual Funds	\$11,245.92

Assets pledged or hypothecated:

NONE

Comments on claims, borrowed money and other liabilities:

Claims appear to be paid promptly and to the satisfaction of the policyholders.

No money was borrowed during the period of examination.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business:

Investments Held Without a Custodial / Safekeeping Agreement

The Company at year-end 2003 invested in securities directly through UBS Financial Services without a custodial / safekeeping agreement as required by Tenn. Code Ann. § 56-3-112 and Regulation 0780-1-46 in order to protect the policyholders from loss. Furthermore, these securities were held by a broker / dealer, UBS Financial Services. Tenn. Code Ann. § 56-3-112 only allows insurance companies "to deposit or arrange for the deposit of securities which it may own in a clearing corporation as defined in Tenn. Code Ann. § 47-8-102, in Euroclear or in a federal reserve bank under book-entry system". UBS Financial Services was not qualified to hold on deposit the Company's securities based upon Tenn. Code Ann. § 56-3-112.

The \$200,000 total value of these two (2) bonds shown in the Company's 2003 Annual Statement and the \$11,245.92 value of the money market mutual fund shown on the Company's 2003 Annual Statement were non-admitted for examination purposes as of December 31, 2003. The \$11,245.92 value of the money market mutual fund was a part of the \$1,368,501 "Cash in Banks" total noted on the Assets Section of the 2003 Annual Statement.

* See the Balance Sheet Error heading (below) under the **Comments on any apparent violations of the laws of the State of Tennessee** section of this report.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (continued):

Balance Sheet Error (Assets)

The Company stated a \$1,368,501 "Cash in Banks" total on the Assets Section – IV of the 2003 Annual Statement. This was composed of the Company's book balance of its checking account adjusted for outstanding checks, the book balance of its two (2) savings accounts, the principal balance of its thirteen (13) certificates of deposit and the market value of its money market mutual fund as stated on the Company's November 2003 UBS Financial Services monthly statement.

The examiners determined that the Company understated the "Cash in Banks" total on the Assets Section - IV of the 2003 Annual Statement by \$1,252.33. This incorrect "Cash in Banks" asset total as of December 31, 2003 was due to the understatement of the \$12,498.25 market value of its money market mutual fund as stated on the December 2003 UBS Financial Services monthly statement. The Company used the \$11,245.44 market value of its money market mutual fund as stated on the November 2003 UBS Financial Services statement in the \$1,368,501 "Cash in Banks" total on the Assets Section – IV of the 2003 Annual Statement.

The \$11,245.92 value of the money market mutual fund shown on the Company's 2003 Annual Statement was non-admitted for examination purposes as of December 31, 2003.

The total Book Value of Bonds and Stocks per examination was determined to be \$11,500 or \$200,000 less than the \$211,500 amount listed by the Company in the 2003 Annual Statement.

The total Book Value of Cash in Banks (including Certificates of Deposit and Money Market Mutual Fund) per examination was determined to be \$1,357,255 or \$11,246 less than the \$1,368,501 amount listed by the Company in the 2003 Annual Statement.

The total Admitted Assets per examination was determined to be \$1,369,155 or \$211,246 less than the \$1,580,401 amount listed by the Company in the 2003 Annual Statement.

Income Statement Error # 1

The Company understated the \$52,443 "Gross Interest" total on the Income Section - II of the 2003 Annual Statement by \$1,252. The December 2003 UBS Financial Services monthly statement reflected the Company received into their account net dividend and interest income totaling \$1,252.81 after a \$75.00 Account Maintenance Fee amount was deducted. Therefore, the "Gross Interest" total on the Income Section - II of the 2003 Annual Statement for examination purposes was determined to be \$53,695.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (continued):

Income Statement Error # 2

The Company incorrectly listed a combined net total of reinsurance premiums paid, reinsurance collected on direct losses, reinsurance commissions received and miscellaneous income on the Schedule of Income (Section II) on the 2003 Annual Statement. The Company should only deduct Reinsurance Premiums paid from Gross Assessments on the Income Statement section of the Annual Statement. The Company should separately list reinsurance commissions received and miscellaneous income as a write-in on the Schedule of Income (Section II) on the 2003 Annual Statement.

The Company incorrectly listed a combined net total of reinsurance premiums paid, reinsurance collected on direct losses, reinsurance commissions received, and miscellaneous income on the Schedule of Income (Section II) on the 2003 Annual Statement. The Company should only deduct Reinsurance Collected on Direct Losses from Gross Amount Paid Policyholders for Losses on the Disbursements Statement section (Section III) of the Annual Statement. The Company should continue to show Re-insurance Commissions on the Schedule of Income (Section II).

Unauthorized Reinsurer

The contract terms of the Company's Second Aggregate Excess of Loss Reinsurance Agreement discloses that Farm Mutual Reinsurance Plan, Inc. insures 20% of the total risk within this agreement. Farm Mutual Reinsurance Plan, Inc. as of December 31, 2003 was not a licensed insurance company in the State of Tennessee or an authorized reinsurer in the State of Tennessee.

Liability Policies

The Company issued liability policies through Farmers Mutual Insurance Company of Knoxville, Tennessee. The Company remitted liability premiums collected to Farmers Mutual on a semi-annual basis. The Company received a 15% commission payment for all liability premium written. The Company combined this commission revenue with reinsurance premiums and reinsurance recoverables on the Schedule of Income on the 2003 Annual Statement.

Schedule of Rates

Changes to the Company's rate schedule and placement guide were made on December 11, 2000 and have been continuously in effect with the approval of the Company's Board of Directors through the end of 2003.

See the attachment to the Exam Report for the Company's rate schedule and placement guide for all new or renewal policies written.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (continued):

Policy Limits, Reinsurance and Retention Limits

Based on the Company's amount of total insurance in force, T.C.A. §56-22-106 sets the maximum amount of coverage the Company is permitted to write on any one risk or hazard subject to one fire or loss at the maximum amount of \$50,000. However, the Company's maximum amount of risk or hazard subject to fire, wind, hail or lightning on any one policy was \$25,000.

There were no apparent violations of the Company's By-Laws.

Recommendations:

It is recommended that the Company implement the following measures of corrective action for purposes of complying with statutory requirements and accepted insurance accounting procedures:

1. The Company should establish a custodial agreement with a financial institution that complies with Tennessee Code 56-3-112 and Regulation 0780-1-46 in order to protect the policyholders from loss.

Subsequent Events:

Subsequent to year end 2003 the Company continues to maintain investments directly through UBS Financial Services without a custodial / safekeeping agreement as required by Tenn. Code Ann. § 56-3-112 and Regulation 0780-1-46. Furthermore, the Company plans to disclose these investments as "Assets Not Admitted" on page 2 on future annual statements and will reduce their "Surplus Over All Liabilities" total accordingly under Section V on page 2 on future annual statements filed with the Tennessee Department of Commerce and Insurance.

As recommended above the Company should establish a custodial agreement with a financial institution that complies with Tennessee Code 56-3-112 and Regulation 0780-1-46 in order to protect the policyholders from loss.

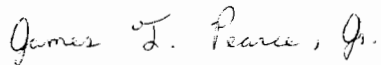
Conclusion

It was determined that, as of December 31, 2003, the Company had admitted assets of \$1,369,155 and liabilities, exclusive of capital, of \$2,293. Thus, there existed for the additional protection of the policyholders, the amount of \$1,366,862 in the form of unassigned funds (surplus).

The complete and courteous cooperation of Mrs. Anita Walcheski, Office Secretary and Mr. David Campbell, Manager/Secretary/Treasurer, extended during the course of the examination is hereby acknowledged.

The assistance of Mr. Robert Scott Creel, Insurance Examiner II, during this examination is also hereby acknowledged.

Respectfully submitted,



James T. Pearce, Jr.
Insurance Examiner in Charge
State of Tennessee

Examination Affidavit:

The undersigned deposes and says that he has duly executed the attached examination report of The Farmers Union Mutual Fire Insurance Company of Bradley County, Tennessee dated November 23, 2004 and made as of December 31, 2003, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says he is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information and belief.

James T. Pearce, Jr.

James T. Pearce, Jr.
Insurance Examiner III
State of Tennessee

County Davidson
State Tennessee

Subscribed and sworn to before me
this 23rd day of
November, 2004.

Helen H. Dorsey
(Notary)

JOHN EADS, PRESIDENT
JOHN H. JOHNSON, VICE PRESIDENT

DAVID CAMPBELL, MGR, SECY & TREAS.

FARMERS' UNION MUTUAL FIRE INSURANCE COMPANY

DIRECTORS
DAVID BEATY
DAVID A. CAMPBELL
JOHN EADS
LESTER ELKINS
CHARLES P. HANNAH
MILTON HUMBERD, JR.
JOHN H. JOHNSON
ROBERT STILL

OF BRADLEY COUNTY
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915 25TH STREET, NW
P.O. BOX 1016
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STORM INSURANCE

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Dept. Of Commerce & Insurance
Company Examinations

State of Tennessee
Dept. of Commerce & Insurance
500 James Robertson Parkway 4th Floor
Nashville, Tennessee 37243-1135

November 30, 2004

Attention: Don Spann

Re: Financial Examination

Dear Mr. Spann:

I would like it noted in the report that we did make an effort to establish a safekeeping agreement for the two Federal Agency bonds that we held in 2003. First Tennessee Bank would not modify their standard agreement to make it meet state requirements. We have contacted other banks and were not able to find one willing to do an acceptable safekeeping agreement.

We have disposed of one bond and will redeem the other bond in December 2006 when it matures. It would cause a loss to redeem it before that time.

Truly Yours,

David A. Campbell
David A Campbell, Sec. & Trea.

Enc. Copy of Letter to James Pearce

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Dept. Of Commerce & Insurance
Financial Affairs / Analytical Section

OPERATED CONTINUOUSLY SINCE 1914
WE INSURE IN BRADLEY, POLK, HAMILTON, McMINN and MEIGS COUNTIES

EXHIBIT

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